DOCUMENT RESUME

ED 311 243 CE 053 248

AUTHOR Starr, Paul
TITLE The Limits of Privatization.
INSTITUTION Economic Policy Inst., Washington, DC.
REPORT NO ISBN-0944826-01-6
PUB DATE 88
NOTE 23p.; An earlier version of this paper appears in "Prospects for Privatization. Proceedings of the Academy of Political Science" (New York, 1987).
AVAILABLE FROM Economic Policy Institute, 1730 Rhode Island Avenue, NW, Suite 812, Washington, DC 20036 ($3.00).
PUB TYPE Information Analyses (070)

EDRS PRICE MF01/PC01 Plus Postage.
DESCRIPTORS Adults; Bureaucracy; Federal Government; Governmental Structure; *Government Employees; *Government Role; Local Government; *Public Agencies; *Public Policy; *Public Service Occupations; State Government
IDENTIFIERS *Privatization

ABSTRACT

Transferring public services and public assets to private ownership is not an entirely new idea. Governments at all levels in the United States have for years contracted out many services. However, under the recently coined label "privatization," such policies now come recommended as a more comprehensive approach to the problems of modern government than ever before. However, the choice is not public or private but which of many possible mixed public-private structures works best. The advocates of privatization use the more moderate ideas to gain plausibility for the more radical goal of government disengagement. The conservatives' view of government as an economic black hole misses what government adds to the productive resources of society and overstates what government takes away. There is a lesson about privatization: governments will continue to be held accountable for economic growth and security. Thus, most privatization efforts would be politically unpopular. The most common privatization proposals would hardly diminish the domain of special interests. Advocates of privatization show an undue tenderness toward private contractors and an undue hostility toward public employees. Although privatization aims to shift services from the public to the private sector, it could end up making private institutions more like public ones. Finally, where the government represents the nation and seeks to speak with one voice, it needs public servants loyal to its highest interests, not private contractors maximizing their own. Although privatization is appealing, the ever-changing public-private mix is necessary in providing public services. (Includes 29 reference notes.) (KC)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

ED311243

The Limits of Privatization

by Paul Starr

Economic Policy Institute

1730 Rhode Island Ave., N.W., Suite 812, Washington, D.C. 20036
(202) 775-8810

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

This document has been reproduced as received from the person or organization originating it.

Minor changes have been made to improve reproduction quality.

Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

"PERMISSION TO REPRODUCE THIS MATERIAL HAS BEEN GRANTED BY

C J Schwartz

TO THE EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)."

CE053248

BEST COPY AVAILABLE

Paul Starr is Professor of Sociology at Princeton University. He is the author of a number of books, including *The Discarded Army: Veterans After Vietnam* (1974) and *The Social Transformation of American Medicine* (1982), for which he was awarded the Pulitzer Prize and the Bancroft Prize in American History. He is currently working on issues concerning the public-private balance and problems of privatization.

This paper, revised for the Economic Policy Institute, appears in an earlier version in Steve Hanke, ed., *Prospects for Privatization* (New York, 1987), Proceedings of the Academy of Political Science.

Economic Policy Institute
1730 Rhode Island Avenue, N.W.
Suite 812
Washington, D.C. 20036

ISBN 0-944826-01-6

The Limits of Privatization

Transferring public services and public assets to private ownership is not an entirely new idea. Governments at all levels in the United States have for years contracted out many services and at various times sold off surplus property and various enterprises judged to be primarily commercial. However, under the recently coined label *privatization* such policies now come recommended with the most extraordinary claims as a more comprehensive approach to the problems of modern government than ever before.

Indeed, some supporters tout privatization as a sovereign cure for virtually all ailments of the body politic. They prescribe it as a tonic for efficiency and economic growth, an appetite suppressant for the federal budget, a vaccine against bureaucratic empire-building, and a booster for individual freedom, including the opportunities of disadvantaged minorities. So remarkable a remedy naturally has broad clinical applications. In the United States, its advocates have called for privatizing such widely accepted forms of public provision as public schools, national parks, waterworks, fire departments, public transportation infrastructure (including airports, bridges, and turnpikes), prisons, Social Security pensions, Medicare, the post office, public hospitals, and social services. The proponents see few limits to privatization because they are convinced that government is generally and incurably incompetent. In the picture of our political world that they draw, a bloated, parasitic public sector blocks the bustle and growth of an otherwise burgeoning private economy. To change that picture, they say we need to put as much of government as possible in private hands.

Some supporters tout privatization as a sovereign cure for virtually all ailments of the body politic.

In this brief essay I mean to challenge both the specific claims made for privatization and the general picture of our political and economic world offered by its advocates. However, my aim is not to present a mirror image of right-wing simplifications by suggesting that public provision is always better than private or that every activity in the public sector ought to remain there forever. A pragmatic public policy must recognize where private alternatives

might work better and, by the same token, where new forms of public provision may ameliorate endemic shortcomings of the market. Most of all, it must recognize that markets are not natural creations; they are always legally and politically structured. Hence the choice is not public *or* private but which of many possible mixed public-private structures works best. And "best" cannot mean only the cheapest or most efficient, for a reasonable appraisal of alternatives needs to weigh concerns of justice, security, and citizenship.

Definitions

Markets are not natural creations; they are always legally and politically structured.

For the sake of clarity, it may be helpful to define some terms. In this paper, *privatization* refers to the shift from publicly to privately produced goods and services.[1] Policies that encourage such a shift include (1) the cessation of public programs and disengagement of government from specific kinds of responsibilities; (2) sales of public assets, including public lands, public infrastructure, and public enterprises; (3) financing private provision of services—for example, through contracting out or vouchers—instead of directly producing them; and (4) deregulating entry into activities that were previously treated as a public monopoly.

These forms of privatization vary greatly in their consequences. They differ, first of all, in the extent to which they reduce public spending and accountability. Contracting out, vouchers, and other systems for paying private providers generally do not obviate the need to collect taxes. And they do not eliminate, though they may reduce, the accountability of public officials for the results of the expenditures. By shifting only the locus of service production, they privatize the means of policy implementation but not the functional sphere of government action. These partial forms of privatization need to be sharply distinguished from the sale of assets and cessation of programs (sometimes called "load-shedding," a term which itself is politically loaded, since it defines public programs as a burden). Yet even the more thorough forms of privatization may involve indirect forms of public subsidy and control. For example, many proposals for asset sales and program termination contemplate the use of tax incentives to stimulate private substitutes for public services. Such incentives influence market outcomes and represent a source of lost revenue (that is, a tax expenditure). Hence there is no certainty that these policies lead toward budgetary balance.

The choice is not public or private but which of many possible mixed public-private structures works best.

The various forms of privatization also differ in their effects on competition. Two related processes, privatization and liberalization, need to be more carefully distinguished than they are in much discussion. In this context, liberalization refers to the opening up of any industry to competitive pressures. The opening up of public monopolies to private firms is a form of privatization that is also liberalizing. However, it is entirely possible to privatize without liberalizing, as the Thatcher government has demonstrated by selling shares of monopolies like British Telecom and British Gas without

significantly subjecting them to competitive forces. Britain has substituted private monopolies for public ones and introduced new regulatory agencies to perform some of the functions previously undertaken through public ownership.[2] Conversely, it is also possible to liberalize without privatizing—that is, to introduce competition into the public sector without transferring ownership. For example, governments may require public enterprises or operating agencies to compete for capital or contracts from higher-level authorities. Indeed, it is even possible to nationalize and liberalize at the same time. In the early 1980s the French socialists both nationalized banks and liberalized financial markets. In other words, things are not as simple as they may first seem.

These distinctions suggest that privatization is not a single set of measures that logically or practically entail one another. Only ideologically and symbolically are the various forms linked. There is an obvious, radical difference between partial and total privatization and a subtle but equally important difference between privatization and liberalization. By treating these heterogenous measures as members of the same family, the advocates of privatization use the more moderate ideas, such as vouchers and contracting out, to gain plausibility for the more radical goal of government disengagement. For example, Milton and Rose Friedman have said explicitly that they would prefer ending all public financing of primary and secondary education, except in hardship cases, but propose vouchers as a more acceptable first step.[3] In an ingenious and refreshingly frank case for privatization, Stuart Butler has argued that the real objective should be to break up "public spending coalitions" to bring about a permanent reduction in the base of political support for government growth.[4] So, while privatization can be presented as a measure to improve the performance of particular services, the larger intention of some exponents is to reduce support for public provision altogether.

The advocates of privatization use the more moderate ideas. . . to gain plausibility for the more radical goal of government disengagement.

Privatization, Public Spending, and Economic Growth

The proponents of privatization see a zero-sum relationship between government and the economy. The bigger the public sector, the smaller the private economy. The more public spending, the less private savings and investment. Hence, in this simple view, privatization is certain to increase savings, investment, productivity, and growth.

If government spending generally retarded economic development, the Western economies with the highest ratios of public expenditures to gross national product would be the slowest growing. However, comparative studies show that not to be the case.[5] The conservatives' view of government as an economic black hole misses what government adds to the productive resources of society and overstates what government takes away. First, much public

The conservatives' view of government as an economic black hole misses what government adds to the productive resources of society and overstates what government takes away.

3

spending represents investment in human and intangible capital as well as physical infrastructure. In the United States, the structure of the Federal budget (which fails to distinguish capital expenditures) and the national income accounts (which treat all government expenditures as consumption) obscure these contributions of public spending to the nation's capital stock and long-run economic development.[6] And, second, much of the contemporary increase in public spending has come in the form of transfer payments, which redistribute income but do not exhaust resources that would otherwise be available for investment. To be sure, the governments of some countries have heavily subsidized inefficient industries, but others have used public programs to reduce opposition to industrial change by cushioning workers against unemployment and retraining them for jobs in expanding sectors. The effect of government on economic growth depends principally on the character of its intervention.

. . . there is a lesson about the limits of privatization: governments will continue to be held accountable for economic growth and security.

The case for privatization as a means of bringing about deep reductions in government activity also neglects the contribution of increased public expenditure to economic stabilization. We have far from abolished the business cycle, but the cycle has been much less severe in the last half century now that the scale of taxation and spending provides governments with the tools of fiscal management that they formerly lacked.

Nor is there the slightest chance that governments will unload responsibility for stability of the economy and the financial system. The voters will not allow it, nor will the banks. When Continental Illinois was on the verge of collapse in 1984, the Reagan administration did not hesitate to rescue it. Governmental assumption of risk, whether for the potential insolvency of pension funds, savings and loans associations, or the international financial system, shows every sign of continuing. In these persistent patterns, there is a lesson about the limits of privatization: governments will continue to be held accountable for economic growth and security. Disengagement from macroeconomic management is impossible.

The theory of "public choice" often provides the rationale for privatization proposals. Public choice analysts attempt to explain political decisions on the same logic as economists apply to markets. In this view, the public arena is nothing but a political marketplace where politicians, public employees, and competing groups of beneficiaries seek their narrow interests — often at the expense of the general welfare. Government expands because bureaucrats maximize their budgets and because beneficiaries with "concentrated" interests in program expansion exercise more political muscle than do taxpayers with "diffuse" interests in restraint.[7] As an explanation for the development of the modern state, the theory is unpersuasive; it cannot explain the variations over time or across societies. If the influences on the budget were always one-sidedly in favor of expansion, spending should have grown rapidly even

in those periods when it has not.[8] The economists' narrowly individualistic view of political choice also provides a misleading view of contemporary politics. Contrary to expectations, the general performance of the economy of the United States seems to weigh more heavily in voting decisions than does the voter's individual economic experience.[9] Nor is the support for public spending as narrowly based as the conservative model of pure self-interest suggests. By overwhelming margins the American public has consistently supported increased spending for most of the programs and services that governments provide.[10] While conservatives puzzle over the political failure of privatization proposals, they miss the most obvious explanation because it undermines their own theory of government growth. Their proposals for privatizing the modern state make little headway because they would be vastly unpopular.

Contrary to expectations, the general performance of the economy of the United States seems to weigh more heavily in voting decisions than does the voter's individual economic experience.

Partial Privatization

The public choice position does describe some obvious realities. Besides serving general interests, the state is also an arena where beneficiaries, politicians, and bureaucrats try to advance their own. But the most common privatization proposals, such as contracting out and vouchers, would hardly diminish the domain of "special" interests. If programs now operated directly by government were shifted to private contractors, the contractors could scarcely be expected to exert less pressure for higher spending than do the much-maligned public employees. In regard to contracting out, Butler has acknowledged that privatization may not break up the "public spending coalitions."[11] This is an understatement: the effect would be to enlarge them.

(Conservatives') proposals for privatizing the modern state make little headway because they would be vastly unpopular.

The most familiar examples of "outsourcing" by government tell the story. By having defense equipment privately produced, we do not reduce the pressure on the defense budget. The defense companies and their employees are quite capable of determining their stake in higher military expenditures. By having highways constructed by private contractors, we do not reduce the pressure for bigger construction appropriations. By having health services under Medicare provided by private doctors and hospitals, we do not obscure from them their interest in higher Medicare appropriations. Indeed, Medicare has done for medical and hospital associations what no liberal persuasion could do—turned them into advocates of higher public spending. The same would be true of educational vouchers, which would add private schools, the families sending children to them, and their teachers to the set of claimants on education budgets. Today public- and private-school constituencies have somewhat different interests, but under a voucher system they would share an interest in getting vouchers set at the highest possible money value.

The advocates of privatization as a means of policy implementa-

tion read the record as showing conclusively the superiority of private providers, but this is an act of heroically selective attention. Given the American experience with defense production, construction projects, and health care—all mostly produced privately with public dollars—it is remarkable that anyone could see a path toward budgetary salvation simply by shifting the locus of service production from the public sector to the private sector. Advocates of privatization show an undue tenderness toward private contractors and an undue hostility toward public employees. They indulge private contractors their history of cost overruns; they rebuke public employees for their history of wage increases. But their preference for private provision actually reflects a deep underestimate of the skills that private firms can deploy. They underestimate the capacity of contractors to manipulate to their own advantage the incentives that are held out to them for better performance. And they underestimate the contractors' capacity to influence political decisions, either illegitimately through bribery or legally through campaign contributions and lobbying. Missing from the case for privatization is any clear sense of feedback effects—the influence on government of the enlarged class of private contractors and other providers dependent on public money.

The most common privatization proposals. . . would hardly diminish the domain of "special" interests.

So, if contracting out and the other forms of partial privatization are to reduce public spending, they cannot be expected to achieve their effect by reducing spending pressure. Private firms have to be far more efficient. Some evidence does suggest that private producers have lower costs, but the picture is complicated by the following:

First, contrary evidence from other studies shows no difference in costs or even higher costs among commercial providers. Among the counterexamples are studies comparing public and commercial electric utilities in the United States.[12]

The advocates of privatization. . . read the record as showing conclusively the superiority of private providers, but this is an act of heroically selective attention.

Second, pervasive differences in the services performed by public and private organizations often render simple comparisons misleading. Especially important are differences in clientele. Public and private schools, hospitals, and social services rarely have the same kinds of students, patients, or clients. If, for example, public schools receive disproportionate numbers of the hard to educate, or public ambulance services carry higher numbers of the poor and uninsured in inner-city areas, any simple comparison of costs, income, and productivity puts the public sector organizations at an unfair disadvantage. The burden of public institutions is precisely that they are often the services of last resort; the freedom of private institutions consists in part of their ability to select the most desirable client populations. To be sure, that selectivity may make them more attractive sources of services, but it does not indicate they perform any better than do the public services when both face the same clients and the same tasks.

Third, most studies comparing public and private organizations

lack any evidence about the quality of services, thereby making it difficult to judge whether lower costs result from greater efficiency or reduced service.

And, fourth, some private firms' lower costs stem primarily from lower wage levels and greater use of part-time workers with fewer fringe benefits.

These alternative explanations for lower costs suggest privatization may sometimes have other effects — and other motives—besides improved efficiency. After all, if privatization enables governments to cut wages and break unions, it is a means of imposing losses on public employees. If it enables governments to cut back services and allows providers to skim off the best clients, it is a means of imposing losses on beneficiaries. Neither of these ways of reducing costs improves efficiency. Perhaps the public wants wages and benefits cut. If so, voters and legislators should do so with their eyes open.

Advocates of privatization show an undue tenderness toward private contractors and an undue hostility toward public employees.

By emphasizing these considerations, I do not mean to suggest that contracting out is never a good idea. It is an important and valuable instrument of public management, but it is treacherous to generalize about its virtues. If contracting were always superior to direct employment, no large corporations would exist. Everyone would be a contractor; no one would be an employee. Whenever private firms decide to employ personnel to carry out a task, they choose bureaucracy over the market. They choose against contracting out whenever they decide to "make" rather than "buy" widgets or to employ their own accountants or sales force rather than contract with an independent accounting firm or independent distributors. There would be manifest disadvantages to contracting for many routine activities—among them a reduced ability to monitor performance and to reorganize production. Furthermore, contractors build up "local knowledge" (or what Oliver Williamson calls "asset-specific" information) that reduces parity among bidders at times of contract renegotiation.[13] These problems of monitoring and control arise for the public as well as the private sector. To be sure, contracting out may give government the flexibility of switching among alternative suppliers, thereby enhancing its bargaining power. However, the advantages are worthwhile only if the government can assure itself of both the reliability of services and the ability to maintain competition at later points of contract renewal. In many markets, competition is weak to begin with and may diminish over time. For example, many small towns and rural areas have only a few potential contractors for some services. Moreover, initial suppliers often gain cumulative insider advantages. To the company that gets the first contract for a complex military project goes the highly specialized knowledge that develops in the course of the work. Competition may also be weak because of an anticompetitive ethos among alternative suppliers (as in the nonprofit sector) or tacit agreements not to underbid (as in the East Coast trash collection

The burden of public institutions is precisely that they are often the services of last resort.

industry infiltrated by organized crime). As a result of these barriers to competition, contracting out may turn out to be a form of privatization that is less liberalizing — and more costly — than it might initially seem.

Vouchers may also produce disappointing and perverse effects. Consider the potential of educational voucher plans to increase the public budget. Since all students would have to be eligible, vouchers would add at least part of the cost of educating children now in private schools. Perhaps more important, vouchers might have a general inflationary impact. Educational voucher plans resemble the system of third-party payment in health care. It is not a happy precedent. Unless barred by new forms of price regulation, private schools would likely raise their fees once vouchers were available to the families that pay their present tuition. In particular, the high-quality private schools that prize their exclusivity might find higher prices to be precisely the means to keep out undesirable students who cannot supplement the vouchers. Besides, like doctors and hospital managers, teachers and administrators in all kinds of schools could think of good things that need to be done with extra funds; and vouchers, like third-party health insurance, would dull the price-consciousness of "consumers," who are in any case less concerned about price than about quality (which, as in health care, they cannot easily judge).

If privatization enables governments to cut wages and break unions, it is a means of imposing losses on public employees.

One suggested cure for these problems is regulation of private school fees, admissions, and other procedures, but new regulation would have the perverse effect of making private schools more public. Indeed, this fear of new controls imposed by legislatures or courts makes many advocates of private schools wary of vouchers or other proposals for public funding. There is a larger lesson in this case. Although privatization aims to shift services from the public to the private sector, it could end up making private institutions more like public ones. If public money flows to private providers, the voters and their representatives are likely to demand greater accountability. The courts are likely to demand greater compliance with constitutional protections of clients' and employees' rights. The very distinctiveness of the sector would probably diminish. In the extreme case, the privatization of public provision could turn out to mean the socialization of private provision.

If contracting were always superior to direct employment, no large corporations would exist. Everyone would be a contractor; no one would be an employee. Whenever private firms decide to employ personnel to carry out a task, they choose bureaucracy over the market.

Thus there is much reason to question the seemingly straightforward view of privatization as a means of reducing government. Butler's argument that privatization would change the dynamics of government expansion is unpersuasive on its face. Private contractors make aggressive lobbyists, as would other recipients of public funds under any proposal to retain government financing but to move production into private hands.

Asset sales do provide a temporary budgetary boost, but only in exchange for public capital. A proper accounting would show no improvement in the government's net financial condition, if the

government receives full value. However, this is often not the case. The experience in Great Britain suggests that for political reasons shares in privatized companies are often underpriced when initially sold. As a result, the early shareholders get windfall profits at the expense of the nation at large.[14] If public assets are sold not through public offerings but to specific firms or other buyers, there are similar risks of underpricing as well as political favoritism in the selection of buyers.

The long-run impact of asset privatization depends primarily on whether private management can make more efficient use of the assets.[15] But because of the complex benefits provided by some public assets (such as public land), this may be exceedingly difficult to determine even in retrospect, much less beforehand. The hope of some advocates of enterprise privatization is that it will discipline management by cutting off government subsidies. However, privatization is no guarantee that subsidies will stop. Private companies are not bashful about asking for help, usually in the form of tax benefits. And if privatization occurs without liberalization, privatized monopolies can obtain subsidies through regulatory protection. In any event, subsidies to government enterprises are not a major budget item in the United States, and some of the agencies that the Reagan administration has mentioned as candidates for privatization, such as the National Technical Information Service (NTIS) and the Federal Housing Administration (FHA), have been self-sustaining.[16] The sale of the public domain could produce significant revenue, but there is little support for selling major portions of it because the public at large wants government to act as a guardian of long-run ecological interests not adequately protected by the market. Even a commission appointed by President Reagan has called for new funds to add to the public lands.

Contracting out may turn out to be a form of privatization that is less liberalizing—and more costly—than it might initially seem.

The one privatization proposal that could undoubtedly have major budgetary consequences is the plan for privatizing Social Security through "super IRAs" (individual retirement accounts). But rather than save money, the proposal would be a genuine budget-buster. Its chief architect, Peter Ferrara, says that current beneficiaries would continue to receive their benefits while workers would be allowed to take tax credits for contributions to enlarged IRAs that would ultimately assume responsibility for retirement income, Medicare, disability insurance, and other benefits.[17] But this plan obviously raises an immense "double payment problem," since the payroll taxes now being collected are spent on current beneficiaries. The money going into super IRAs would have to come from somewhere. If workers were allowed credits against their payroll taxes for contributions to super IRAs, Social Security would require a vast infusion of general revenues; and if workers could take credits against their income taxes, general revenues would fall sharply. Either way, the federal deficit would increase dramatically. Ferrara's answer is that the new savings in super IRAs would so greatly spur economic

Although privatization aims to shift services from the public to the private sector, it could end up making private institutions more like public ones.

growth that all would end happily; and to prove his case, he gives estimates of real returns to investment that are wildly out of line with historic patterns or any reasonable economic expectations.[18] President Reagan and Congress believed in one supply-sided miracle when they slashed income tax rates in 1981, expecting to ride the Laffer curve back to solvency. Another such supply side miracle and the country will be dead broke.

Choice, Equality, and Citizenship

Another such supply side miracle and the country will be dead broke.

The case for privatization includes other claims besides improved efficiency, budget savings, and increased economic growth. The key word is *choice*. Advocates claim that privatization will enlarge the range of choice for individuals while serving the same essential functions as do traditional programs. Thus, if Social Security were privatized, the Federal government would still require people to put aside funds for retirement but would allow them to choose their own retirement investments. Educational vouchers would not abolish laws requiring children to go to school but would let families choose which one. Asset sales and shifts of services from public agencies to private contractors might permit greater choice among suppliers.

Proponents of privatization maintain that greater choice would serve the interests of equity. The rich have always been able to afford private schools; educational vouchers would give the middle classes and the poor that ability. Social Security, they say, favors whites, whose longer life expectancy enables them to receive greater retirement benefits than do blacks; privatization would allegedly correct that bias. According to privatizers, greater freedom of choice will generally lead to a more just distribution of benefits.

Individual choice in the marketplace is not the only kind. Democratic societies offer another mode of choice through political participation.

Choice is unquestionably the single strongest point in the case for privatization. The uniformity of public programs and services is often a grave limitation. Even where it is not logically required, the demands of equal treatment are often interpreted to prohibit variety in public services. Public schooling, public transportation, and public recreation facilities, to take some obvious examples, are not typically custom-tailored to individual taste; people with other preferences seek out private alternatives. Rules requiring uniform pricing by government agencies also impede the production of varied services, especially those of high quality.[19] These barriers to variety have long been a weakness of public services, but the problem grows more serious as personal income increases with economic growth. Larger numbers of consumers demand the more diverse, specially designed services previously available only to those with the highest incomes. This demand for customized, "up-market" services constitutes a source of dissatisfaction with the public sector that may be expected to grow.

Yet while recognizing the handicaps of the public sector in providing for variety, we ought not to accept uncritically the concep-

tion of choice that the privatization proponents offer. Individual choice in the marketplace is not the only kind. Democratic societies offer another mode of choice through political participation. Conservatives usually emphasize the drawbacks of political choice: the preferences of outvoted minorities are not satisfied, and representation is imperfect. But there are reasons to prefer democratic politics to markets in the making of some decisions. Most obviously, each citizen gets one vote, but in the marketplace people with more money have more "votes." The democratic polity also does not simply register preferences; it subjects them to public discussion. Deliberation creates opportunities for criticism and mutual persuasion, for interest to confront interest, sometimes to discover common ground. The whole point of a republican system of government is to set in motion these processes.

The democratic polity also does not simply register preferences; it subjects them to public discussion.

Privatization does not transform constraint into choice; it transfers decisions from one realm of choice—and constraint—to another. These two realms differ in their basic rules for disclosure of information; the public realm requires greater access; private firms have fewer obligations to conduct open proceedings or to make known the reasons for their decisions. The two realms differ in their recognition of individual desires; the public realm recognizes equal voting rights, while the market recognizes unequal purchasing power. The two realms provide different environments for forming preferences. Democratic politics, unlike the market, is an arena for explicitly articulating, criticizing, and adapting preferences; it pushes participants to make a case for interests larger than their own. Privatization diminishes this public sphere—the sphere of public information, deliberation, and accountability. These are elements of democracy whose value is not reducible to efficiency. If we are to respect preferences, as conservatives urge that we do, we ought to respect preferences for democratic over market choice where they have been long and consistently demonstrated. As Amy Gutmann has pointed out, individuals exercise choice as much when they vote themselves public schools—or for that matter any public services—as when they buy services in the market.[20]

Privatization diminishes this public sphere—the sphere of public information, deliberation, and accountability.

Moreover, the removal of decisions from the public arena diminishes the individual incentive for community participation. Public schools, in particular, are a principal motivation for the participation of parents in local elections; the vitality of local government depends on their involvement. Privatization of the schools would weaken the foundations of local democracy.

Democratic politics is more than an alternative mode of choice; government opens up choices that are not available in the market. When markets fail to provide goods and services, voting enables the public to purchase them. Advocates of privatization concede the appropriateness of government intervention for public goods, but they say that except for a few cases (such as national defense) the public sector can as readily buy the services as produce them

(and that even within the category of national defense more can be privatized than is at present). However, the difficulty of privatizing some public goods is that public administration is essential to their character. I have in mind, first of all, the administration of justice, foreign policy, military defense and other exercises of coercive power (as in prisons), the collection of taxes, and other functions where the state exercises its peculiar prerogatives of sovereignty. In these areas the state's authority, supported by its monopoly of legitimate violence, rests on the claim to be acting impartially on behalf of the entire community. Privatization calls upon motives of private gain, weakening the grounds of authority and the capacity to assert collective interests over more narrow ones. It is particularly dangerous for the state to put coercive power over persons in the hands of employees accountable, in the first instance, to a private firm. Conservatives not only view politics too narrowly as a political marketplace; through privatization they would help to turn it into more of one than it is now.

The removal of decisions from the public arena diminishes the individual incentive for community participation.

In a variety of market failures, government intervention often expands the range of choices available to individuals. Consider the case of broadcasting. Commercial networks and stations sell audiences to advertisers; the programs are merely bait for the audience's attention. But the attention of children has relatively little economic value, since it cannot be sold except to brand-name food and toy producers, who sponsor only a limited amount of programming, little of it educational. The production of educational programming requires action outside of the market, which in the United States has taken the mixed form of combined government and philanthropic support. Public broadcasting has expanded the diversity not only of programs but of decision- making processes about programs, and it has given priority to educational and cultural values that have little influence elsewhere. Public provision has thereby expanded the alternatives offered by the broadcasting system as a whole.[21]

The difficulty of privatizing some public goods is that public administration is essential to their character.

Social Security is another, though quite different, example of the capacity of government to open up possibilities closed off in the market. Insurance markets suffer from severe problems of moral hazard and adverse selection. By creating a single risk pool, Social Security provides protection to those who could not afford it at market rates.[22] The conservatives' argument that Social Security penalizes disadvantaged minorities overlooks some crucial facts. Although blacks collect retirement benefits for fewer years on average, the progressive benefit structure of Social Security enables them to collect more during those years than they would from private policies. (In any event, private insurance firms could not charge blacks less than whites for annuities because it would be unconstitutional for them to use racial classifications. The only way for blacks to derive savings because of their lower life expectancy would be to buy less coverage.) The privatization of Social Security would, therefore, reduce the income of the black elderly and make many

more of them dependent on means-tested welfare benefits. In addition, blacks and other disadvantaged minorities depend especially on other components of Social Security, such as disability, health insurance, and survivors' benefits. Because of their higher costs in these areas, many of them could not purchase privately the full package of Social Security benefits. When taken as a whole, Social Security is a bargain for low-income groups. It is disingenuous of privatization advocates to claim that the poor would benefit from a change that eliminates the progressive benefit structure and sends them into a private market reluctant to serve people likely to have higher health insurance, disability, and survivors' claims.[23]

Conservative critics complain that broad-based public programs like public education, public television, and Social Security are poorly targeted; middle-class recipients get subsidies they do not need. This is an odd complaint to hear from those who often recommend the use of tax expenditures, which may be the least well targeted of all forms of public subsidy (and are even less controllable than entitlement programs, since they are not subject to the annual appropriations process). The benefits of public education and Social Security are distributed far more equally than those of the private markets they supplement or supplant; and, besides, the programs ought not to be seen narrowly as income transfers. We pay taxes for schools to educate not just some parents' children but the next generation of citizens. Even childless adults have a stake in the survival of their society. We do not pay Social Security taxes solely to sustain the aged but also to keep up a compact that rolls over from one generation to the next. These are the frameworks of a commonwealth. Linking the fate of the poor to the majority strengthens their common sense of membership in the nation. The poor gain more from the vigilance of middle-class voters than they lose from any scattering of scarce benefits. Narrow targeting of public programs promotes the political isolation of their beneficiaries; it feeds resentments of the excluded lower-middle classes and exposes the poor to retribution. Programs that target benefits on the poor can also target cutbacks. Witness the cutbacks in "welfare" programs over the past fifteen years. A large-scale shift of public services to private providers would contribute to further isolating the least advantaged, since private firms have strong incentives to skim off the best clients and most profitable services. The result would often be a residual, poorer public sector providing services of last resort. Such institutions would be even less attractive as places to work than they are today. And their worsening difficulties would no doubt be cited as confirmation of the irremediable incompetence of public managers and inferiority of public services. Public institutions already suffer from this vicious circle; most forms of privatization would intensify it.

Privatization must be seen not only as a technical instrument of policy but as a political measure of symbolic consequence. If the

It is particularly dangerous for the state to put coercive power over persons in the hands of employees accountable, in the first instance, to a private firm. Conservatives not only view politics too narrowly as a political marketplace; through privatization they would help to turn it into more of one than it is now.

Public broadcasting has expanded the diversity not only of programs but of decision-making . . .

Federal government were to sell Yosemite, it might provide a tidy sum for the Treasury but the real loss would not be the park itself but the sense of a common nation with enduring values other than money. The great national parks are a common legacy, and the message of their ownership should be that they belong to no private party but to the people as a whole. In relation to the administration of justice and exercise of coercive power, the symbolic import of privatization would also be of paramount importance. Meting out justice is a communicative act; its public character ought not to be confused. When the government prosecutes a tax evader or a court sentences someone convicted of a crime, it sends a message to the entire community about the public values and rules that the community lives by. Privatization of justice (as in some "rent-a-judge" services or the privatization of prisons) confuses the message that the rendering of justice ought to communicate. And where the state represents the nation and seeks to speak with one voice, it needs public servants loyal to its highest interests, not private contractors maximizing their own. The Reagan administration's "privatization of foreign policy" in the Iran-*contra* affair was objectionable, in part, because private agents assumed foreign policy prerogatives that properly belong only to publicly accountable officials. Of course, foreign policy is one area where privatization advocates have not explicitly called for privatization, but there is a similarity. Privatization is a means for removing decisions and activities from the public arena where they may not meet general approval.

By creating a single risk pool, Social Security provides protection to those who could not afford it at market rates.

Privatization signals diminished access. When distributive justice is at issue, privatization signals a diminished commitment to include the poor in the national household. That is clearly the message that would be read from the privatization of welfare, if by that is meant reliance on the "spur" of individual poverty (as George Gilder and Charles Murray advise us) or on acts of private charity, even if encouraged by tax deductions or credits.[24] Relying entirely on charity, as John Goodman recommends, would give no assurance that the poor would receive equitable treatment—that the black poor, for example, would not be treated less favorably than poor whites.[25] The privatization of Social Security would carry the same message of indifference to greater inequality. Upon retirement, some people would find they had done well with their personal IRAs, but others who gambled unsuccessfully in the stock market would face personal ruin. The privatization of the schools would symbolize a final retreat from the already faded ideal of bringing the disparate children of a community under a common roof.

The benefits of public education and Social Security are distributed far more equally than those of the private markets they supplement or supplant.

However, the symbolic load of privatization ought not to be a categorical objection to all the various measures that are covered by that term. As I indicated at the beginning, the term covers a heterogenous set of policies, some more worthy than others. We need not accept or reject all the elements as a single package. Like corporations, states ought to be able to divest themselves of some

activities and take on others. They should be able to contemplate exchanging or liquidating assets, to compare buying with producing services, and to entertain new forms of competition within the public sector or between public and private organizations.

Communications provides an example of an industry where dramatic technological change may result, over the long term, in a reworking of public-private relationships. The Postal Service is our oldest public enterprise, and it remains today a critical component of the national communications system. However, it no longer has the same practical and symbolic importance in knitting together the nation that it once did.[26] Its historic function has been partly superseded by other means of communication, and the prospect of still further technological change will eventually require a reconceptualization of its role. Year by year, the costs of transmitting paper messages increase, while the costs of transmitting electronic messages fall. The advance of facsimile transmission and videotext ultimately promise to cut into the high volume of letter traffic that the Postal Service requires to spread its fixed costs. Already, advances in "hard copy" transmission are permitting large institutions to bypass the postal system. And with the growth of private parcel delivery, private overnight express services, and private messenger services in downtown areas, the old "postal monopoly" has radically diminished.

Narrow targeting of public programs promotes the political isolation of their beneficiaries; it feeds resentments of the excluded lower-middle classes and exposes the poor to retribution.

At this stage in the "communications revolution," there is still good reason to retain a national postal system that provides first-class mail service with uniform prices to all areas of the country. Economic development in rural areas and small towns would suffer a devastating blow from the breakup of the Postal Service, much more so than they have from airline deregulation. But the rationale for the postal system as a public enterprise may be an anachronism 25 or 35 years from now, as electronic hard-copy transmission becomes much cheaper and puts rural locations on an equal footing with urban ones.

Privatization must be seen not only as a technical instrument of policy but as a political measure of symbolic consequence.

In the meantime, restructuring the Postal Service may involve some limited forms of privatization. Like the railroads, which have discovered immense value in their real estate (most of it originating from nineteenth-century federal land grants), the Postal Service possesses a good deal of property that might well be more productively used. One of its chief competitors, the United Parcel Service, typically has facilities in much less valuable urban locations; yet, evidently, many people find UPS at least as convenient to use—indeed, it has now taken two thirds of the parcel delivery business. In restructuring the Postal Service, we might well consider selling some of its assets, such as downtown distribution centers that were built next to railroad terminals at a time when much mail went by rail. As transportation and communications technologies change, it is simply unreasonable to suppose that the structure of postal communications ought to remain unaltered.[27]

Housing provides another example of the potential for restructuring public assets. Unlike education and justice, housing is not a service that Americans believe government should produce and manage; it is a private good that exemplifies the demands for variety that government is poorly equipped to meet. Housing policy in the United States has always been highly privatized—too often in the interests of the developers, one might add.[28] Public housing accounts for only a small portion even of the housing that government has subsidized. To be sure, those who live in public housing—and the many more on waiting lists—value it highly. But public housing projects might be privatized if they can be sold to tenant cooperatives that show promise of effectively operating and maintaining them. However, given the extremely low incomes of public housing tenants, it would be naive to suppose that many such projects could be sold to tenant cooperatives and successfully maintained by them long into the future.[29] In addition, such sales as can be made ought not to rule out building new public housing where the private market shows no sign of responding to the needs of the homeless. In some areas of policy like housing, government ought to move its investments in a kind of rolling privatization — disposing of some public assets while augmenting others.

Where the state represents the nation and seeks to speak with one voice, it needs public servants loyal to its highest interests, not private contractors maximizing their own.

In adjusting the public-private balance, we need to be attentive, sphere by sphere, to the special practical and moral considerations that arise in each. No single remedy is appropriate to the vastly different problems that distinguish collecting taxes from collecting trash, running schools from running railroads, managing prisons from managing shipyards. Nor ought we to reduce our choices to a simple public/private dichotomy. We have a more extensive repertoire of intermediate options in organizational forms and modes of ownership, control, and finance. The illusory appeal of privatization is to provide a single solution for many complex problems. But if the idea of privatization has any merit, it is to remind us, if we had forgotten, that the public-private mix ought not to be considered settled for all time and to force us to rediscover the moral and political foundations of the public services we need.

NOTES

[1] For a discussion of this and other conceptions of privatization, see my paper "The Meaning of Privatization," in *Privatization and the Welfare State*, ed. Alfred Kahn and Sheila Kamerman (forthcoming).

[2] See John Kay, Colin Mayer, and David Thompson, eds., *Privatisation and Regulation: The UK Experience* (London: Oxford University Press, 1987); Samuel Brittan, "The Politics and Economics of Privatisation," *Political Quarterly* 55 (Winter 1985), 109–27.

[3] Milton and Rose Friedman, *Free to Choose* (New York: Harcourt Brace Jovanovich, 1980), 161–63.

[4] Stuart M. Butler, *Privatizing Federal Spending: A Strategy to Eliminate the Deficit* (New York: Universe Books, 1985).

[5] Peter Saunders, "Public Expenditure and Economic Performance in OECD Countries," *Journal of Public Policy* 5 (1986), 1–21; David R. Cameron, "The Expansion of Public Economy: A Comparative Analysis," *American Political Science Review* 72 (December 1978), 1243–61; and, more generally, Robert Kuttner, *The Economic Illusion: False Choices Between Prosperity and Social Justice* (Boston: Houghton Mifflin, 1984).

[6] See Simon Kuznets, "National Income: A New Version," *Review of Economics and Statistics* 30 (August 1948), 151–79; Robert J. Gordon, "$45 Billion of U.S. Private Investment Has Been Mislaid," *American Economic Review* 59 (June 1969), 221–38; John W. Kendrick, *The Formation and Stocks of Total Capital* (New York: Columbia University Press, 1976); and Robert Eisner, *How Real is the Federal Deficit?* (New York: The Free Press, 1986).

[7] For the "public choice" view of government growth, see Thomas Borcherding, ed. *Budgets and Bureaucrats: The Sources of Government Growth* (Durham, N.C.: Duke University Press, 1977).

[8] See Richard A. Musgrave, "Leviathan Cometh — or Does He?" in *Tax and Expenditure Limitations*, ed. Helen F. Ladd and T. Nicolaus Tideman (Washington, D.C.: Urban Institute Press), 77–120.

[9] The evidence against the public choice view of political behavior is summed up in Gary R. Orren, "Beyond Self-

Interest," in *The Power of Public Ideas*, ed. Robert Reich (Cambridge, Mass.: Ballinger Publishing, 1987), 13–29 and Steven Kelman, "Why Public Ideas Matter," *ibid*, 31–54. For a theoretical response to public choice claims, see also Carlisle Ford Runge, "The Fallacy of 'Privatization,'" *Journal of Contemporary Studies* (Winter 1984), 3–17; and for an experimental study contradicting economists' assumptions about free riding, see Gerald Marwell and Ruth Ames, "Economists Ride Free, Does Anyone Else?" *Journal of Public Economics* 15 (June 1981), 295–310.

[10] This was true even at the height of the tax revolt when Proposition 13 passed in California. See David O. Sears and Jack Citrin, *Tax Revolt: Something for Nothing in California* (Cambridge, Mass.: Harvard University Press, 1982), esp. Ch. 3.

[11] Butler, *Privatizing Federal Spending*, 56.

[12] For more skeptical readings of the evidence on public versus private ownership, see Robert Millward, "The Comparative Performance of Public and Private Ownership," in *The Mixed Economy*, ed. Lord Roll of Ipsden (London: Macmillan Press, 1982), 58–93; George W. Downs and Patrick D. Larkey, *The Search for Government Efficiency* (Philadelphia: Temple University Press, 1986); and Charles T. Goodsell, *The Case for Bureaucracy: A Public Administration Polemic* (Chatham, N.J.: Chatham House Publishers, 1983). On the performance of electric utilities, see Millward's review and R. Fare, S. Grosskopf, and J. Logan, "The Relative Performance of Publicly-Owned and Privately-Owned Electric Utilities," *Journal of Public Economics* 26 (1985), 89–106.

[13] Oliver E. Williamson, *The Economic Institutions of Capitalism* (New York: The Free Press, 1985).

[14] See Colin Mayer and Shirley Meadowcroft, "Selling Public Assets: Techniques and Financial Implications," in *Privatisation and Regulation: The UK Experience*, Kay, Mayer, and Thompson, eds., 322–40.

[15] Richard Hemming and Ali M. Mansour, "Privatization and Public Enterprises," International Monetary Fund Working Paper, February 25, 1987.

[16] The Proposals to sell the FHA and NTIS met instant opposition not only from Congress but from the private sector. See "Experts Assail Plan for F.H.A.," *The New York Times*, December 16, 1985, and "Congress Wary on Plan to Sell Assets," *ibid*, February 6, 1986. On the NTIS and, more generally, the privatization of information resources, see Paul Starr and Ross Corson, "Who Will Have the Numbers? The Rise of the

Statistical Services Industry and the Politics of Public Data," in *The Politics of Numbers*, ed. William Alonso and Paul Starr (New York: Russell Sage, 1987).

[17] Peter J. Ferrara, "Social Security and the Super IRA: A Populist Proposal," in *Social Security: Prospects for Real Reform*, ed. Peter J. Ferrara (Washington, D.C.: Cato Institute, 1985), 193–220. For a more extensive treatment, see Peter J. Ferrara, *Social Security: The Inherent Contradiction* (San Francisco: Cato Institute, 1980).

[18] I present a more extended critical analysis in my paper, "Social Security and the American Public Household," in *The Politics of Social Security*, ed. Theodore Marmor and Jerry Mashaw (Princeton, N.J.: Princeton University Press, forthcoming).

[19] Sam Peltzman, "Pricing in Public and Private Enterprises and Electric Utilities in the United States," *Journal of Law and Economics* 14 (1971).

[20] Amy Gutmann, *Democratic Education* (Princeton, N.J.: Princeton University Press, 1987).

[21] New developments in cable and other technologies are unlikely to supply the broader educational and cultural needs that public television has met. See my paper, "Television and the Public Household," in *Television in America's Future—A Search for the Right Public Policy*, ed. Michael Rice (forthcoming).

[22] Even as severe a critic of Social Security as Michael J. Boskin acknowledges the need for a public program to overcome the problems of the insurance market. See his *Too Many Promises: The Uncertain Future of Social Security* (Homewood, Ill.: Dow Jones-Irwin, 1986).

[23] For further development, see my paper "Social Security and the American Public Household."

[24] George Gilder, *Wealth and Poverty* (New York: Basic Books, 1981); Charles Murray, *Losing Ground: American Social Policy, 1950–1980* (New York: Basic Books, 1984).

[25] John C. Goodman, "Privatizing the Welfare State," in Steve Hanke, ed., *Prospects for Privatization* (New York: Academy of Political Science, 1987).

[26] Wayne E. Fuller, *The American Mail: Enlarger of the Common Life* (University of Chicago Press, 1972).

[27] For discussion of policy options, see Joel L. Fleischman, ed., *The Future of the Postal Service* (New York: Praeger, 1983).

[28] Gosta Esping-Andersen and I have used the term "passive intervention" to describe government policies in health care and housing that excessively accommodate private provider interests. See our paper "Passive Intervention," *Working Papers for a New Society* 7 (July-August 1979), 15–25.

[29] Peter Drier, "Private Project," *The New Republic*, August 4, 1986.